

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

Rules Applicable to Baseline
And Functionally Equivalent
Negotiated Service Agreements

Docket No. RM2003-5

**NOTICE OF THE UNITED STATES POSTAL SERVICE
OF FILING OF CORRECTED VERSION OF REPLY COMMENTS**

The Postal Service hereby gives notice that it is filing a complete corrected version of its Reply Comments that both incorporates the errata filed today and corrects pagination errors in the original document.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice.

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REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE
(October 14, 2003)

The Postal Service hereby provides reply comments to the initial comments filed in response to Order No. 1383, proposing new rules to govern Commission proceedings relating to Negotiated Service Agreements (NSAs).¹ Rather than discussing *seriatim*

¹ On October 10, 2003, the Office of the Consumer Advocate (OCA) filed an unauthorized document supplementing its initial comments on the proposed rules in the instant proceeding. Office of the Consumer Advocate Supplemental Comments on NSAs vs. Pilot Tests, Docket No. RM2003-5 (Oct. 10, 2003). In its supplemental comments, the OCA referred to the Commission's recent Order No. 1385 in Docket No. C2003-2, which involved, among other issues, participation in a pilot test conducted by the Postal Service. The OCA observed similarities between the practice of testing operational changes prior to implementation and the NSA approach to rate and classification changes. It concluded by inviting the Commission to incorporate in its rules or accompanying commentary some guidance controlling future pilot tests.

Procedurally, as well as substantively, the OCA's initiative is out of place in this proceeding. It is founded on a complicated and controversial question involving the circumstances under which any activity pursued by the Postal Service and its customers or others might rise to the level of an undertaking that must be pursued through a rate or classification proceeding at the Commission. This topic has been the focus of several recent complaint proceedings under 39 U.S.C. § 3662, and has been a source of disagreement between the Postal Service and the Commission, as well as the OCA and other parties.

Conversely, the current rulemaking docket was initiated to carry out the Commission's stated intention, in its Recommended Decision in Docket No. MC2002-2, (footnote continued...)

each party's initial comments in their entirety, this document is organized by topic, addressing particular portions of the proposed rules as necessary.

The Postal Service views NSAs as a constructive development in postal ratemaking. Accordingly, the Commission's efforts to set rules that can eliminate uncertainty, especially from the perspective of potential NSA partners, should be applauded.

The critical elements of different NSAs will vary, as each NSA will in some measure be unique. In general, therefore, as explained in our initial comments and below, a "rule of reason" guideline should control. In any event, NSA regulatory requirements that exceed those applicable to other types of proceedings are not justified, in large part, since the financial and operational ramifications of NSAs typically will be smaller.

Proposed Rule 5

The Postal Service's Initial Comments did not address the proposal to add "Negotiated Service Agreement" to definitions of commonly used terms in the

(...footnote continued)

to develop specialized procedures to facilitate review of Postal Service proposals based upon NSAs. As proposed in the Commission's rules, NSAs represent a specific kind of arrangement between the Postal Service and particular mailers that they voluntarily seek to implement through rate and classification changes pursuant to the statutory ratemaking scheme. Interjection of the issues raised in the OCA's supplemental comments at this point will only impede and complicate establishment of useful specialized procedures. Accordingly, the Postal Service believes that this NSA rulemaking docket should be limited to procedures for NSAs, rather than extended into the areas of product development and operational tests for service changes that may lead to service wide changes. The OCA's proposal should be rejected as untimely and inappropriate.

Commission's Rules of Practice and Procedure (39 C.F.R. § 3001.5). Since then, the Office of the Consumer Advocate (OCA) has filed a pleading commenting on certain implications of the proposed specialized NSA procedures that the OCA perceives in relation to activities or arrangements that arguably might be described as having the character of NSAs. As explained above, we do not believe that the OCA's observations warrant change or comment by the Commission in the instant rulemaking proceeding.²

Having focused on the proposed definition in this light, however, we now believe that one refinement might be beneficial. The Commission's proposal describes an NSA as a contract "that provides for customer-specific rates or fees and/or postal services in accordance with the terms and conditions of the contract." While the use of the term "postal services" in this context would not strictly speaking be inaccurate in all instances, it is too restrictive. We believe that a more precise definition of an NSA should focus on the Commission's statutory functions with regard to rates and mail classifications. In this regard, the broader term "classification" would encompass both distinct levels of service, as well as less expansive changes to provisions in the Domestic Mail Classification Schedule (DMCS). Accordingly, we recommend that the definition of NSA refer to arrangements that involve "rates or fees and/or classification changes."

² See footnote 1 above.

Proposed Rule 190

In support of its suggested additions to paragraph (b) of proposed Rule 190, the OCA argues that the rules must require the Postal Service to “demonstrate that *each* major service *element* is individually making a material additional contribution to institutional costs” and must “preclude contribution neutral NSAs (or elements thereof)” OCA Comments at 3-4 (emphasis added). The OCA urges “a requirement for an in-depth Postal Service analysis showing that *each element* of a future NSA will make a material additional contribution to institutional costs.” OCA Comments at 8 (emphasis added). These contentions are unrealistic and counterproductive. It is not hard to imagine a situation in which the Postal Service would provide additional services to a mailer for which the Postal Service would incur costs. If that were the only element of an NSA, then presumably the mailer would pay a surcharge for the service. But there might be little incentive for either party to enter into such an arrangement without other element(s). If another element involved worksharing by the mailer that avoided costs incurred by the Postal Service in a measure that exceeded costs to the Postal Service from the first element, there would be an overall benefit to the Postal Service in the form of additional contribution. Application of the OCA’s proposed element-specific test would operate to preclude an NSA based upon these two elements, to the ultimate detriment of the Postal Service and all mailers.³

³ The OCA’s statement on page 3 in conjunction with this argument that “the ‘additional contribution’ from new mail volume [generated by the Capital One NSA block discounts] was actually negative” is erroneous. While the overall effect of the block discounts was negative owing to revenue leakage, the effect of new volume was itself positive. These facts are clearly stated in the OCA’s cite: Tr. 2/309. The possible impact of new
(footnote continued...)

Any NSA needs to be considered as a whole. So long as the overall agreement results in positive contribution, there is no need to subject particular features to independent financial tests. OCA's position here is consistent with its assertion early in Docket No. MC2002-2 that each element of the Capital One NSA should instead constitute its own niche classification. The effect would be to eliminate most of the potential benefits that NSAs could provide, and for no discernable good reason. The Commission reached this conclusion in the Capital One case, when it dismissed the suggested separate consideration of each element of that agreement as "not ... pragmatic." PRC Op., MC2002-2, at 29.

Unlike several participants, the Postal Service does not believe the Commission intends to attempt to "renegotiate" agreements that are presented to it by the Postal Service and its partner(s). This issue was raised and decided in the Capital One case. The Commission relied on the APWU's cogent explanation that the nature of negotiations is such that their results may not appear to outside observers to be the best deal possible. The Commission recognized that its role is to determine whether NSAs put before it pass muster under the Act; not whether the Postal Service could have negotiated a "better" deal. PRC Op., MC2002-2, at 39; see *also* PostCom Comments at 5.⁴

(...footnote continued)

volume is further confirmed by witness Crum (Tr. 3/282) in a response which directly refutes the OCA's surprising, novel assertion that the new volume contribution was "actually negative."

⁴ Unlike Postcom (at 4), the Postal Service does not understand the Commission's commentary on proposed Rule 193(b) to reflect a Commission expectation that NSA requests will be based on un-executed NSAs. The Commission may be indicating in its
(footnote continued...)

The OCA's penchant for renegotiation manifests itself in the suggestion to add to paragraph (b) of Rule 190 a sentence reading:

It shall be the policy of the Commission to require declining-block rates to be supported by a company-specific demand analysis justifying each volume threshold and corresponding rate.

This proposal, if finalized, would amount to a bar on declining block arrangements. The structure of a declining block rate agreement needs to be negotiated by the parties. It is unlikely, if not impossible, that a "company-specific demand analysis" would be available, and, even if such an analysis were available, it is unclear how the OCA believes that it could be used to "justify" each proposed volume threshold, as opposed to all other possible volume thresholds. The Postal Service strongly opposes all of the OCA's suggested revisions to Rule 190(b).

NNA argues that the Postal Service should be required "to prove that a niche classification case would not be an equally reasonable approach." NNA Comments at

4. The Commission already rejected this illogic in the Capital One case:

The Commission's predisposition to prefer more inclusive mail classifications is not a sufficient basis for canonizing ... [the] proposed requirement that NSAs be supported by a showing that its expected benefits could not be achieved through a niche classification. The Postal

(...footnote continued)

commentary that signatures are not required in PDF files. The Commission clearly contemplates, however, that the terms of the agreement be settled and agreed to by the parties before a case is filed. Order No. 1383, at 9. Although the Commission presumes that "the agreement does not go into effect until after the Commission submits its opinion and recommended decision and the Governors ... provide ... [their] approval," *id.*, the fact of the matter is slightly different. Certainly, the rates and classification elements of the agreement are not effective until all these milestones are reached, but there were other provisions of the Capital One agreement that became effective upon signing and did indeed bind the Postal Service and Capital One. See, e.g., Section IV, paragraph D; Section V.

Service and any co-proponent bear the burden of demonstrating that the proposed NSA is compatible with statutory policies, as well as the applicable ratemaking and mail classification factors. The Commission is not inclined to complicate this process by adding a requirement that would further burden the proponents by tasking them with what would, in effect, be proving a negative.

PRC Op., MC2002-2, at 33. Testimony in that docket explained what made the Capital One situation unique; moreover, as a practical matter, if a particular combination of terms that could become an NSA suited multiple mailers, the Postal Service indicated it would, in conformity with its economic interest, pursue a niche classification. The Commission should accordingly decline to adopt NNA's proposal.

Proposed Rule 193

Paragraph 193(a) General Requirements

The Postal Service opposes the OCA's proposed modifications to draft proposed Rule 193(a) regarding the general requirements for the content of formal requests based upon NSAs. The OCA proposed deletion of subparagraphs 193(a)(2) to (4), thereby falling back upon the general waiver provisions of Rule 22. Because of its concern that a grant of a waiver when required information is unavailable will affect the burden of proof, the OCA also recommends modifications to many of the remaining subparagraphs of 193(a) to ensure that the burden of proof is not vitiated.

While the Postal Service disagrees with the OCA's analysis of the proposed subsection, the OCA's discussion highlights an anomaly in this Rule's treatment of unavailable information as compared to rules governing other proceedings. This anomaly, which requires a waiver rather than a detailed statement when information is unavailable, amounts to a daunting entry barrier that, because it will likely result in

unnecessary procedural disputes, serves to dissuade potential NSA partners from negotiating. Accordingly, the Postal Service recommends that the wording of Rule 193(a) be amended as discussed below to conform with rules applicable to other Commission proceedings, and as shown in the attachment to this pleading.

Proposed Rule 193(a)(2) is modeled after Rules 54(a)(2) and 64(a)(2) but with a significant difference. Rule 54(a)(2) and 64(a)(2) are identical:

If any information required by paragraphs (b) through [the last paragraph] of this section is not available and cannot be made available without undue burden, the request shall provide where reference is made to this paragraph, in lieu of such information, a statement explaining with particularity:

- (i) The information which is not available or cannot be made available without undue burden;
- (ii) The reason or reasons that each such item of information is not available and cannot be made available without undue burden;
- (iii) The steps or actions which would be needed to make each such item of information available, together with an estimate of the time and expense required therefore;
- (iv) Whether it is contemplated that each such item of information will be supplied in the future and, if so, at what time; and
- (v) Whether sufficiently reliable estimates are available to mitigate the need for such information, and if so, the specifics of such estimates.

Proposed Rule 193(a)(2) is identical in all pertinent respects to the quoted text except as highlighted below:

If any information required by paragraphs (b) through [last paragraph] of this section is not available and cannot be made available without undue burden, *the request shall include a request for waiver of that requirement supported by a statement explaining with particularity:*

* * *

Proposed Rule 193(a)(2) would be the only rule governing proceedings before the Postal Rate Commission that would require a waiver instead of a statement explaining the unavailability. Rules for requests involving Experimental Changes, Expedited Minor Classification Changes, and Provisional Service Changes of Limited Duration all provide that the Postal Service should explain the unavailability as required in Rule 64(a)(i)(ii) and (iv).⁵ See Rule 67b; Rule 69a(b); Rule 172(b), respectively. None requires the filing of a request for a waiver.

Requiring a request for waiver when information is unavailable will invite opposition to the granting of the waiver. It will require the Commission to conduct a factual inquiry into whether information is unavailable, whether the burden of producing the data is “undue,” and whether the Postal Service has otherwise met the requirements set forth in subparagraph 193(a)(2).

A statement of unavailability avoids these needless and possibly time-consuming disputes.⁶ The request will set forth the statement with particularity as provided in subparagraphs (2)(a). If, the Commission needs further information, it can be requested pursuant to (a)(6): “The Commission may request information in addition to that required by paragraphs (b) through (k) of this section.” By following the rules of practice

⁵ The Postal Service recommendation to delete subparagraphs 193(a)(iii) and (v) (See the Postal Service’s Initial Comments at 4-5) is consistent with its position in these reply comments that Rule 193(a) should be parallel to the rules governing other proceedings before the Commission. The Postal Service notes that Rules 67b, 69a(b) and 172b all provide that the Postal Service should explain the unavailability as required in Rule 64(a)(i), (ii) and (iv), thus deleting reference to subparagraphs 193(a)(iii) and (v). It would be consistent with those special proceedings to have the statement of unavailability comply with Rule 64(a)(i), (ii) and (iv).

⁶ See DMA *et al.* at 6, 10.

for other proceedings, where unavailability is explained in statements rather than as part of a request for a waiver, the Commission places this issue in the appropriate context. The focus of the inquiry should be whether the evidentiary record establishes by a preponderance of evidence that the requested changes comply with the Postal Reorganization Act, not whether waiver should be granted. Accordingly, the Postal Service recommends that the wording in the body of proposed Rule 193(a)(2) be amended to conform to the wording of the introductory paragraph of Rules 54(a)(2) and 64(a)(2).

The OCA proposed the deletion of subparagraph 193(a)(3), which requires a motion for waiver when the Postal Service concludes that necessary information is not relevant to the NSA. The Postal Service disagrees, since it is appropriate to seek a waiver when it believes that information required in Rule 193(b) through (k) is not relevant or material. A determination about whether required information is relevant at the beginning of the proceeding is useful and will aid the development of the record. Unlike the factual inquiry that would be involved when a waiver is being sought for unavailable information, the threshold question of the immateriality or irrelevance of nominally required information should be straightforward.

As for subparagraph 193(a)(4), which governs the effect of granting a waiver, the Postal Service notes that this same language is part of the rules governing Experiments Changes, Minor Classification Changes and Provisional Classification Changes and there is no need to delete them from the pending proposal. The Postal Service also notes that the Commission would address many of the OCA's concerns about the effect of subparagraph 193(a)(4) by adopting the Postal Service's recommendation that the

unavailability of required information be explained in a statement rather than in a request for a waiver.

Rule 193(e) Financial Analysis

Many of the initial comments submitted in response to Order No. 1383 address the financial analysis portion of the proposal, Rule 193(e). It appears to the Postal Service, however, that several parties providing comments may have overlooked some of the flexibility already built into paragraph (e). Specifically, some comments suggest that, if mailer-specific costs or elasticities were unavailable and the Postal Service and its NSA partner were instead relying on proxies, a request for waiver to that effect would be required when filing the case. See, for example, the comments of Capital One at pages 3-4, DMA et al., at pages 9-10, and MMA, at 5. The Postal Service does not interpret the proposed rules in this fashion. As indicated on page 15 of the Postal Service Initial Comments, when proxies are used in lieu of mailer-specific costs or elasticities, in conjunction with an appropriate discussion of such proxies' suitability, the provisions of paragraph (e) of Rule 193 are met without resort to any other portion of the Commission's rules regarding waiver (in Rule 193, or elsewhere).

More generally, this point and related comments properly raise the issue of the scope of Rule 193(e). Several comments note that precise volume forecasts and elasticity estimates are not needed when discounts are less than estimated cost savings to the Postal Service. See, e.g., First Data, at 2-3, and DMA, et al. at 6-7. Related comments appear at MMA, at 5-6, Pitney Bowes, at 4, and Discover, at 6-7. Volume forecasts are quite pertinent to NSA proposals involving declining block rates, unlike

proposals in which rate changes are not linked to volume changes. Stated more broadly, the scopes of critical information and relevance vary for different types of NSA proposals.

This conclusion does not dictate what rules might be best. One option might be to attempt definitional categories of potential NSA proposals within paragraph (e) of Rule 193, and then, for each category, limit required information to that specifically deemed appropriate for that category. Without knowing the full potential range of possible NSAs, such an approach might well prove counterproductive. Future experience may shed better light on this possibility.

At this time, the Postal Service favors an approach that focuses its efforts and those of its potential NSA partners, on obtaining the best possible estimates for critical elements of a proposal. Consequently, if total volumes are largely immaterial, the Postal Service would not expect to devote major resources to development of precise volume forecasts. The more critical a role an NSA element plays, the greater the resources would be expended on refining the forecast for that element. This approach constitutes a “rule of reason” interpretation of the requirements of paragraph (e) of proposed Rule 193.

Such an approach seems particularly appropriate in light of the serious concerns raised by mailers regarding volume forecasts in the out years of a proposed agreement. Capital One states these concerns quite explicitly on pages 5-6 of its initial comments, characterizing mailer-specific volume forecasts over a three-year forecast horizon as “wishful thinking.” Similar views appear on page 7 of the comments of DMA, et al. A number of comments also address the broader issue of the need to maintain the

confidentiality of sensitive business information. First Data, at 5-7, Pitney Bowes, at 7; MMA, at 6; and Discover, at 6-7. All of these concerns appear to be well-founded.

How concerns about out year forecasts, including mailer-specific costs and confidentiality of information, map into the proposed rules, in particular Rule 193(e), is not especially transparent. The Postal Service Initial Comments include a suggested restructuring of paragraph (e) that distinguishes first-year analyses from those for subsequent years; the emphasis for later years is on identifying and quantifying potential material changes from the first year. While the Postal Service appreciates that this revision would not eliminate concerns over the difficulty of out-year forecasts, it is intended to create a framework under which the task at least becomes somewhat more manageable.

The issue of confidentiality of mailer-specific information generally presents a potentially more serious problem. As noted, several of the commentators warn of the prospect that inability to fashion reliable protection against unwarranted disclosure of confidential business secrets and information may represent a serious impediment to exploring and developing beneficial NSAs and subsequent rate and classification changes in the future. The lack of some procedural guarantees, or at least guidelines that would make minimum expectations clear, might inhibit all but the most intrepid mailers from participating in the search for mutually beneficial NSA arrangements.

We wholeheartedly agree that the need to balance the legitimate concerns about confidentiality with the statutory ratemaking scheme and the Commission's responsibilities presents a formidable obstacle to crafting practical and successful specialized procedures for NSAs. In this regard, we note that the Commission was

faced with a related issue in formulating rules to carry out its function of preparing an annual report to Congress on international mail costs, revenues, and volumes under 39 U.S.C. § 3663. In that instance, the Commission opted to indicate a procedure for identifying the Postal Service's confidential commercial information when it is submitted, and to rely upon laws governing the public status of government-held information to determine disclosure. While this approach in itself is not trouble-free, it has worked so far.

The chief difficulty with regard to the Commission's proposed NSA procedures arises from the lack of experience in dealing the problem in the different contexts that might represent a variety of unforeseen, particularized relationships between the Postal Service and individual NSA partners. In the Capital One proceeding, the Commission was able to accommodate the proprietary concerns of Capital One regarding specific information it considered commercially valuable, to the apparent satisfaction of all. The Postal Service expects that a similarly accommodating approach could be found for other NSA proposals.

In this respect, we note that page 9 of Order No. 1383 indicates that a higher burden may be required to justify confidential treatment of any information included with the text of the contractual NSA (proposed paragraph (b) of Rule 193). The Postal Service believes imposition of such a higher burden is not well advised. Nor would it be necessary. As First Data discusses at some length in its comments (at 5-7), other agencies seem able to balance public interest and disclosure concerns, even for contractual terms of an agreement.

For the time being, the Commission and the parties might succeed with a case-by-case approach to gain more experience from which to better understand the obstacles. Eventually, however, a more systematic procedural mechanism that would create more reliable expectations and protections would be preferred. We suggest that the issue be revisited in a subsequent rulemaking that would focus on possible solutions.

The Postal Service does, however, endorse the textual changes in paragraph (e) proposed by PostCom on pages 5-6 of its initial comments regarding contrasting and inconsistent use of “estimated before rates” scenarios versus “actual and estimated” after rates ones.” First, PostCom is correct that the proposed language of subparagraph (e)(5) should be brought into conformance with the language of subparagraph (e)(4) by removing the “actual and” language from (e)(5). It was never clear why the “before-rates” scenario of (e)(4) would call only for “estimated” financials, while the “after-rates” (e)(5) scenario calls for “actual and estimated” financials. In its suggested version of the new rules, attached to its initial comments, the Postal Service had already proposed reconciling the two provisions by dropping the “actual and” language from the after-rates scenario, exactly as PostCom has now likewise suggested. In agreeing with PostCom on this issue, the Postal Service perforce disagrees with the alternative OCA suggestion (OCA Comments at 15-16) to achieve symmetry by adding the “actual and” language to the before-rates scenario, rather than deleting it from the after-rates. The availability of actual financial information for a future period seems equally unlikely in either scenario.

PostCom also proposes (at 5-6) some reshuffling of proposed paragraph (e)(5), the primary effect of which would be to streamline the structure and remove certain redundancies. The Postal Service views these suggestions as beneficial. Of course, PostCom's refinements have been set forth in the context of paragraph (e) as originally proposed, rather than in the context of the Postal Service's suggested restructuring of the paragraph. Attached to these comments is a version of paragraph (e) that combines the suggestions of PostCom with those of the Postal Service. The only material deviation in this attachment from what PostCom seems to be suggesting in its initial comments is an explicit retention of language regarding the suitability of proxies, which, under the Postal Service's proposed version, appears as part of Rule 193(e)(1)(v).

The Postal Service finds the OCA's suggested changes to Rule 193(e) to be unwarranted. In addition to the "actual and estimated" suggestion discussed above, the Postal Service also opposes the suggestion that a reference to the workpaper provisions of 193(h)(4) be inserted in the portion of paragraph 193(e) describing the level of detail required for references to cited material. OCA Initial Comments at 15. The proposed rules already require that documentation "be prepared in sufficient detail to allow independent replication." The OCA's proposal is not only superfluous but adds imprecision, because a second statement of a single requirement necessarily implies that they constitute distinct requirements.

The Postal Service also opposes the OCA's suggestion to substitute the word "analysis" for the word "discussion" in those portions of paragraph (e) regarding the effects of the NSA on contribution, and the suitability of proxies. OCA Initial Comments

at 16. In neither instance would anything useful be gained by the proposed substitution, and the term “analysis” in this context could be misconstrued.

Lastly, the Postal Service also opposes the proposed insertion of an additional subparagraph regarding the “net present value” of the proposed NSA. OCA Initial Comments, at 16. The OCA indicates that the purpose of this addition would be to account for the time value of money. Such a purpose might make sense if the costs and benefits expected in the out years could be as clearly delineated as the costs and benefits expected in the first year. As discussed in the Postal Service’s initial comments (pages 8-11), however, the information pertaining to the out years is likely to be much more hazy. The OCA’s proposed subparagraph on net present value would therefore add far more needless complication than real substance.

The Postal Service also opposes the proposal NNA makes at pages 6-7 of its Comments to include within Rule 193 a provision requiring that estimated costs (*i.e.*, those intended to be created or saved by virtue of the proposed NSA) be presented by cost segment. The purported benefit of such a provision, according to NNA, would be to allow other mailers, particularly small mailers, to “be better able to identify potentials for functionally-equivalent arrangements.” NNA Comments, at 6-7. This rationale, however, does not withstand scrutiny. It is difficult to conceive how small mailers could benefit in this regard from what can only appear to them as the arcane knowledge that a particular transportation cost saving accrued primarily in Cost Segment 8 (Motor Vehicle Service drivers) rather than in Cost Segment 14 (Purchased Transportation), or that a carrier cost saving accrued in Cost Segment 7 (Street Time) rather than in Cost Segment 6 (In-Office Time). Even the hypothetical examples presented by NNA – a

local bank and a small advertising mailer – shed no light on why the linkage of cost savings to CRA cost segment would facilitate those mailers' efforts to identify and obtain derivative negotiated agreements. NNA's proposal in this regard should be rejected as unnecessary and burdensome.⁷

Rule 193(f) Impact Analysis

Many commenters, including DMA et al., First Data, MMA, Pitney Bowes, and Capital One Services, Inc., urge deletion or mitigation of proposed Rule 193(f), which would require the upfront filing of a competitive impact analysis. These parties point out that, under certain interpretations, the new requirements would prove unnecessary, impractical and/or unduly burdensome. As is evident from the Postal Service Initial Comments on Rule 193(f), the Postal Service shares these parties' concerns that the proposed requirement of impact analysis could become an unnecessary impediment to the filing of NSA requests. The Postal Service also strongly agrees with those who point out that the information necessary to estimate the effect of an NSA on Postal Service competitors, and on competitors of an NSA party, is unlikely to be available to the Postal Service and those entering into the NSA. In these circumstances, it is reasonable, fair and efficient for the Commission, and its rules, to focus primarily on the

⁷ Obviously, in usual circumstances, the primary cost segment or segments associated with the relevant cost estimates would be easily discernible from the filing to those familiar with the cost segment accounting framework. Notwithstanding that reality, however, there is no useful purpose to be served by the extraneous insertion of the type of provision proposed by NNA on this subject.

reaction of the competitors in question to provide information on any competitive harm that may allegedly flow from the NSA in question, without expecting a high-level, detailed analysis to be filed at the outset by the NSA proponents.⁸ As the Commission had ruled in the past, the burden of proof is appropriately borne by those alleging competitive harm. Neither the Postal Service nor its NSA partners should be held to a test that requires them to prove a negative.

The Postal Service recognizes, however, that with respect to particular types of NSAs, *i.e.*, those not strictly cost-based and which involve optional tariffs and the sale of a monopolized input, the Commission, following Professor Panzar's advice, may well seek additional evidence concerning competitive impact, as it did in the *Capital One* case. For example, as in *Capital One*, the Commission may question whether one effect of the NSA might be to reduce the consumption of postal services by competitors of the party to the NSA, and thereby have an impact on the overall contribution of the Postal Service. Progress of the case might be enhanced if available information pertaining to such issues were provided at the outset, rather than be introduced midstream. In the interests of expedition, therefore, the Postal Service would be willing to provide information with its filing concerning the competitive context in which the NSA

⁸ If some harm to a Postal Service competitor were anticipated as a result of an NSA, this would not in itself constitute grounds for rejecting the NSA. The Postal Service expects that in evaluating competitive impact under proposed Rule 193(f)(2), the PRC will be concerned with protecting *competition*, not particular competitors. See *Direct Marketing Association v. United States Postal Service*, 778 F.2d 96 (2nd Cir. 1985). Furthermore, we agree with the comment of Pitney Bowes that "Adverse effects on competitors that result from recognizing and rewarding operational efficiencies should not be viewed as anticompetitive." Comments of Pitney Bowes Inc. at 8.

takes place, and otherwise qualitatively demonstrate that it has considered such competitive effects prior to filing the NSA request.

Proposed Rule 196

The Commission's proposed rules distinguish baseline NSAs from those based on an existing NSA. The Postal Service's Initial Comments at 23-25, propose calling the latter "derivative NSAs," to replace the Commission's proposed term, "functionally equivalent." Nevertheless, the Postal Service is not contending that "derivative" is the ideal term and the Commission might wish to consider other more appropriate terminology, including the use of more neutral terms such as category 1 and category 2 NSAs.

The Postal Service Initial Comments supported proposed Rule 196 and suggested that it be modified to require participants five days before the pre-hearing conference to identify issues they wish to contend. This should facilitate the Commission's expedited consideration of derivative NSAs.

It should be remembered that the first derivative NSA has yet to be considered. Accordingly, the comments of EW Consulting⁹ urge caution in making rules for derivative NSAs based solely on the Commission's experience with the Capital One NSA. Valpak agrees, noting that there could be differences of opinion among the Postal Service, the partner in a derivative NSA, and the Commission.¹⁰ By variously and, at

⁹ Comments of EW Consulting Relative to Retail Applications (September 30, 2003).

¹⁰ Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc. Comments on Proposed NSA Rules Pursuant to Commission Order No. 1383 (October 29, 2003), at 5.

times, inconsistently arguing that rules for derivative NSAs should be (1) based on the Reorganization Act, (2) determined *a priori* by the Commission, and (3) deduced from the DMCS criteria for defining “functional equivalence” to Mailing Online – all without actually identifying any useful criteria – Valpak both illustrates the difficulty the Commission faces in trying to define what similarities matter in the context of NSAs and overlooks a fundamental reality of NSAs. That reality is the fact that before the Commission gets an opportunity to review a derivative NSA, the Postal Service and its partner to a derivative NSA must themselves agree on the pertinent NSAs terms. The similarities and differences between that NSA and its baseline will thereafter be presented to the Commission for consideration. The Commission’s recognition (also quoted by Valpak in its Comments at 4) that the salient similarities between a baseline and a derivative NSA will need to be handled on a case-by-case basis is correct.

The comments of Discover¹¹ commend the Commission for recognizing that expedited procedures are necessary for consideration of derivative NSAs. Discover provides an additional suggestion in this regard: insertion in Rule 196 of a five business day deadline after the pre-hearing conference for the Commission to determine whether a proposed derivative NSA should appropriately be considered as such. Discover Comments at 2 n.1. The Commission should be able to meet this deadline easily, especially if contended issues are identified – as proposed by the Postal Service – five days ahead of that conference.

¹¹ Comments of Discover Financial Services, Inc. (September 30, 2003).

Conclusion

WHEREFORE, the Postal Service urges the Commission to move forward on rules for Negotiated Service Agreements by issuing new proposed, or final, rules that incorporate the changes reflected in its Initial Comments, as amended by these Reply Comments and further amendments to the Rules reflected in the attachment hereto.

Respectfully submitted,

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ALTERNATIVE RULE LANGUAGE SUGGESTED BY THE POSTAL SERVICE

Proposed changes shadowed below constitute changes from language proposed in the Attachment to the Postal Service's Initial Comments. For the sake of simplicity, the entire original Attachment is reproduced below.

§ 3001.5 Definitions.

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(r) *Negotiated Service Agreement* means a written contract, to be in effect for a defined period of time, between the Postal Service and a mailer, that provides for customer-specific rates or fees and/or classification changes in accordance with the terms and conditions of the contract.

Subpart B – Rules Applicable to Requests for Changes in Rates or Fees

Rule 51 Applicability

The rules in this subpart govern the procedure with regard to requests of the Postal Service pursuant to § 3622 of the Act that the Commission submit a recommended decision on changes in a rate or rates of postage or in a fee or fees for postal service if the Postal Service determines that such changes would be in the public interest and in accordance with the policies of the Act. The Rules of General Applicability in Subpart A of this part are also applicable to proceedings on requests subject to this subpart. For requests of the Postal Service based on Negotiated Service Agreements, the Rules Applicable to Negotiated Service Agreements, Subpart L, supersede the otherwise applicable rules of Subpart B.

Subpart C – Rules Applicable to Requests for Establishing or Changing the Mail Classification Schedule

Rule 61 Applicability

The rules in this subpart govern the procedure with regard to requests of the Postal Service pursuant to § 3623 of the Act that the Commission submit a recommended decision on establishing or changing the mail classification schedule. The Rules of

General Applicability in Subpart A of this part are also applicable to proceedings on requests subject to this subpart. For requests of the Postal Service based on Negotiated Service Agreements, the Rules Applicable to Negotiated Service Agreements, Subpart L, supersede the otherwise applicable rules of Subpart C.

Rule 193 Content of Formal Requests

(a) General requirements.

- (1) Each formal request filed under this subpart shall include such information and data and such statements of reasons and bases as are necessary and appropriate fully to inform the Commission and the parties of the nature, scope, significance, and impact of the proposed changes or adjustments in rates, fees, and/or the mail classification schedule(s) associated with the Negotiated Service Agreement, and to show that the changes or adjustments are in the public interest and in accordance with the policies and the applicable criteria of the Act. To the extent information is available or can be made available without undue burden, each formal request shall include the information specified in paragraphs (b) through (k) of this section. If the required information is set forth in the Postal Service's prepared direct evidence, it shall be deemed to be part of the formal request without restatement.
- (2) If any information required by paragraphs (b) through (k) of this section is not available and cannot be made available without undue burden, the request shall provide where reference is made to this paragraph, in lieu of such information, a statement explaining with particularity:
 - (i) The information which is not available or cannot be made available without undue burden;
 - (ii) The reason or reasons that each such item of information is not available and cannot be made available without undue burden; and
 - (iii) Whether it is contemplated that each such item of information will be supplied in the future and, if so, at what time.

(c) Rates and standards information. Every formal request shall include a description of the proposed rates, fees, and/or classification changes, including proposed changes, in legislative format, to the text of the Domestic Mail Classification Schedule and any

associated rate or fee schedule(s).

(e) *Financial analysis.* Every formal request shall include an analysis, as described in paragraph (e)(1) of this section, of the effects of the Negotiated Service Agreement on Postal Service volumes, costs and revenues in a one-year period intended to be representative of the first year of the proposed agreement. If the agreement is proposed to extend beyond one year, the request shall also include an analysis of the effects of the agreement on Postal Service volumes, costs and revenues in each subsequent year of the proposed agreement, as described in paragraph (e)(2) of this section. For each year, the analysis shall provide such detail that the analysis of each component of a Negotiated Service Agreement can be independently reviewed, and shall be prepared in sufficient detail to allow independent replication, including citation to all referenced material.

- (1) The financial analysis for the one-year period intended to be representative of the first year of the proposed agreement shall:
 - (i) set forth, to the extent practical, the estimated mailer-specific costs, volumes, and revenues of the Postal Service for that year, assuming the then effective postal rates and fees absent the implementation of the Negotiated Service Agreement;
 - (ii) set forth, to the extent practical, the estimated mailer-specific costs, volumes, and revenues of the Postal Service for that year which result from implementation of the Negotiated Service Agreement;
 - (iii) include a discussion of the effects of the Negotiated Service Agreement on contribution to the Postal Service for that year (including consideration of the effect on contribution from mailers who are not parties to the agreement);
 - (iv) provide the basis used to determine such costs, revenues, and volumes (including elasticity factors); and
 - (v) include a discussion of material variances between mailer-specific estimates and system-wide average data, and the suitability of any proxies proposed to be used for mailer-specific factors.
- (2) The financial analysis for each subsequent year covered by

the agreement (if the proposed duration of the agreement is greater than one year) shall:

- (i) identify any factors known or expected to operate in that subsequent year which might have a material effect on the estimated costs, volumes, or revenues of the Postal Service, relative to those set forth in the financial analysis provided for the first year of the agreement in response to paragraph (e)(1) of this section. Such relevant factors might include (but are not limited to) cost level changes, anticipated changes in operations, changes arising from specific terms of the proposed agreement, or potential changes in the level or composition of mail volumes;
- (ii) discuss the likely impact in that subsequent year of each factor identified in paragraph (e)(2)(i), and quantify that impact to the maximum extent practical; and
- (iii) estimate the cumulative expected effect in that subsequent year of all of the factors identified in paragraph (e)(2)(i) on the estimated costs, volumes, and revenues of the Postal Service, relative to those presented for the first year of the agreement in response to paragraph (e)(1) of this section.

(f) *Impact analysis.* Every formal request shall include an analysis of the impact over the duration of the Negotiated Service Agreement on:

- (1) competitors of the parties to the Negotiated Service Agreement other than the Postal Service;
- (2) competitors of the Postal Service; and
- (3) mail users.

The Postal Service shall include a copy of any completed special studies that were used to conduct such analyses. If special studies have not been performed, the Postal Service shall state this fact and explain the alternate bases of its analyses.

(g) *Data collection plan.* Every formal request shall include a proposal for a data collection plan, which shall include a comparison of the analysis presented in § 3001.193(e)(1)(ii) with the actual results ascertained from implementation of the Negotiated Service Agreement. The results shall be reported to the Commission on an annual or more frequent basis.

(j) Rejection of Requests **[As explained in the text of these comments, this paragraph should be omitted.]**

Rule 195 Requests to Recommend a Baseline Negotiated Service Agreement

(b) The Commission will treat requests predicated on a baseline Negotiated Service Agreement as subject to the maximum expedition consistent with procedural fairness. The schedule for adoption of a recommended decision will therefore be established, in each case, to allow for issuance of such decision not more than 150 days after the filing of the request of the Postal Service. Nothing in this section shall be construed to affect the rights of the Postal Service or other parties with respect to temporary implementation of changes pursuant to section 3641 of the Act.

Rule 196 Requests to Recommend a Negotiated Service Agreement That Derives Key Components from a Previously Recommended Negotiated Service Agreement.

(a) This section governs Postal Service requests for a recommended decision in regard to a Negotiated Service Agreement that includes key components from a Negotiated Service Agreement previously recommended by the Commission and currently in effect. The previously recommended Negotiated Service Agreement shall be referred to as the baseline agreement. The purpose of this section is to establish procedures that provide for accelerated review of derivative Negotiated Service Agreements. The Postal Service request shall include:

- (1) a detailed description of how the proposed Negotiated Service Agreement is, and is not, based on components of a baseline agreement;
- (2) identification of the record evidence from the baseline agreement docket, or any other previously concluded docket, on which the Postal Service proposes to rely, including specific citation to the locations of such evidence;
- (3) any available special studies developing information pertinent to the proposed Negotiated Service Agreement;
- (4) if applicable, the identification of circumstances unique to the request; and

- (5) if applicable, a proposal for limitation of issues in the proceeding, except that the following issues will be relevant to every request predicated on a functionally equivalent Negotiated Service Agreement:
- (i) the financial impact of the Negotiated Service Agreement on the Postal Service over the duration of the agreement;
 - (ii) the fairness and equity of the Negotiated Service Agreement in regard to other users of the mail; and
 - (iii) the fairness and equity of the Negotiated Service Agreement in regard to affected markets.

(b) When the Postal Service submits a request derived from an existing Negotiated Service Agreement, it shall provide written notice of its request, either by hand delivery or by First-Class Mail, to all participants in the Commission Docket established to consider the baseline agreement. Any participant, not limited to those who appeared in a previous Docket, who intends to contend a particular issue in a derivative docket shall identify such issue(s) not later than 5 days before the pre-hearing conference.

(c) The Commission will schedule a pre-hearing conference for each request. Participants shall be prepared to address whether or not it is appropriate to proceed under § 3001.196 at that time. After consideration of the material presented in support of the request, identification of any contended issues, and the argument presented by the participants, if any, the Commission shall, not later than five business days after the pre-hearing conference, issue a decision on whether to proceed under § 3001.196. If the Commission's decision is not to proceed under § 3001.196, the docket will proceed under § 3001.195.

(d) The Commission will treat requests derived from an existing Negotiated Service Agreements as subject to accelerated review consistent with procedural fairness. If the Commission determines that it is appropriate to proceed under § 3001.196, a schedule will be established which allows a recommended decision to be issued not more than:

- (1) 60 days after the determination is made to proceed under § 3001.196, if no hearing is held; or
- (2) 120 days after the determination is made to proceed under § 3001.196, if a hearing is scheduled.

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice.

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